# Environmental Policy Issues in the "New Normal" Era of China

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Worries about global economic growth frequently made headlines in 2015 and worsened early this year. There are bearish views even in the United States, which is enjoying a steady, if not typical, recovery from the Great Recession. Playing a big factor in this gloomier outlook are the growth prospects in China. The country's GDP growth had averaged 10.6 percent per year during 2001–2011, with a massive stimulus sustaining high growth during the two years following the global financial crisis of 2007–2008. Since then, however, growth has decelerated sharply, down to 6.9 percent in 2015 according to China's official GDP estimates. Since then, the term "New Normal" has spread from discussions in China to headlines across the world (see the box on page 9).

A slower-growing GDP could derail optimistic government plans for economic and environmental reform if the pressure to maintain growth results in a familiar pattern of energy-intensive investment in low-return infrastructure projects, such as buildings that sit empty and roads that go unused. Yet a different policy that promotes investments in energy efficiency, public transportation, pollution control equipment, and renewables would smooth the transition to the New Normal while reducing China's severe air and water pollution.

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## Reform Ambitions Meet Reality

In 2013, newly installed leaders of the Communist Party announced their plans to reform the economy and government. The communique of the closely observed "Third Plenum" of the party, held in November 2013, speaks to balanced and equitable growth, environmental protection, and the key roles of markets in resource allocation.

The plan was to rebalance the economy away from the previous investment- and export-led growth and toward growth driven by consumption. Currently, China has one of the world's lowest consumption-to-GDP ratios. Such a switch of production away from investment goods, such as steel and cement, would lead to a less energy-intensive economy. It would also mean less air pollution, addressing the great public concern about the nation's extremely poor air quality—dubbed "airpocalypse" by the news media.

The unexpected slowdown since then has shifted emphasis back to maintaining growth. In speeches in November 2015, President Xi and Prime Minister Li announced that growth should be no less than 6.5 percent for the next five years, a target they seem to believe is necessary for social stability. Such an emphasis on growth might mean a delay, or a revision, of the reform plans. China has a decentralized government, where provincial officials wield substantial authority over local economic decisions, and it is easy to imagine many provinces returning to a familiar path of investment in infrastructure to reach such targets. Whether or not such a high invest-

**Is China Headed for the "Middle-Income Trap"?**

Growth deceleration has been a topic of intense discussion within China. As far back as June 2011, the *Economist* reported that "officials and experts debate endlessly whether the country is slowly heading towards a 'middle-income trap,'" a situation where countries are unable to sustain high growth rates that had transformed them from poor to middle-income countries. As the World Bank noted in its report *China 2030*, "Of 101 middle-income economies in 1960, only 13 became high income by 2008."

This way of thinking about growth is misleading, however; many countries that did not become rich in 50 years would go on to do so in 60 or 70 years.

The debate held around 2011 had many arguing then that China would be able to sustain 8 percent growth rates for two more decades. Such views are less common today, with the OECD projecting in its November 2015 *Economic Outlook* that China's growth will slow further to 6.2 percent in 2017. But even if growth slowed to as little as 4 percent during 2020–2030, China would still escape the so-called trap—and energy consumption would continue to grow at about 2 percent per year without a big change of policy.

ment path would succeed in sustaining 6–7 percent growth, production of steel, cement, electricity, and other energy-intensive commodities would increase, resulting in higher levels of pollution and carbon emissions than envisioned in the earlier plans for a smooth rebalancing of the economy.

There are indications of this return to investment. In 2012–2014, the investment share of GDP exceeded 46 percent, even higher than the 40 percent that prevailed in the years before the global financial crisis. This higher investment has replaced the greatly diminished trade surplus and left the consumption share around 38 percent, which is similar to the share in 2006–2007. For comparison, the investment share in Korea peaked at 37 percent in 1991, while the US share was 20 percent during the dot-com boom.

## Policy Choices in the Age of the "New Normal"

Two big initiatives are related to China's focus on investment. The first is the "One Belt, One Road" initiative of President Xi. This confusingly translated strategic initiative refers to the project to develop infrastructure—through a state-owned $40 billion Silk Road Fund—along the land route to Central Asia (the "belt") and the maritime route through the Straits of Malacca to Pakistan and on to Africa (the "road"). The second is the creation of the Asian Infrastructure Investment Bank, championed by China to facilitate financing of large infrastructure projects in Asia, arguing that existing institutions such as the World Bank are too cumbersome. The primary motivation behind these two initiatives may be political considerations to expand Chinese influence along the New Silk route and in Asia. The economic slowdown introduces an additional need to sustain demand for Chinese industrial output.

By themselves, these initiatives are not large relative to China's GDP of $10.4 trillion, but there could be large multiplier effects in a period of low global growth—especially in the countries receiving these infrastructure investments, but perhaps also within China. For example, Silk Road investments in Greece have turned the port of Piraeus into one of the fastest growing in the region. At a minimum, the Chinese

leadership believes these initiatives will serve as new flexible institutions to implement an investment-led strategy.

These international initiatives may be complemented by domestic investment initiatives. Whether such investment strategies will lead to greater energy and emission intensities depends on the nature of the investments. A common criticism of the recent policies, including those in the stimulus following the global financial crisis, is that the investments were made in low-return projects, as symbolized by empty buildings and little-used roads. A continuation of such poor project choices would contribute little to future GDP and to more energy use and pollution.

I believe there is an alternate response to the economic slowdown that would maintain a high level of investment and have a high social return: a policy that promotes investments in energy efficiency, public transportation, pollution control equipment, renewables, electricity infrastructure, and the like.

Currently, roads sit empty in some places, while elsewhere, such as in Beijing, too-few roads and a lack of public transportation spell ever-worse congestion. China's power system presents another place to prioritize investments. Integration of wind and solar energy into the power system has been very poor for various institutional and structural reasons but could be much better. Promoting exports of such environmental equipment and construction would contribute to maintaining employment and reducing global pollution.

Returns on such public investments do not show up on any enterprise's accounts, but they would have a social rate of return in the form of lower transportation and health costs that would be reflected in higher future productivity. The social return would also include a more flexible and reliable electricity grid that would help lower the costs of mitigating greenhouse gas emissions. This would be a win-win-win strategy—it allows the government to follow a familiar path of economic development policy, it would maintain aggregate demand and employment, and it would promote energy conservation and pollution reduction in the future, even if the short-run impact is greater output of energy-intensive goods. As Nobel Laureate Joseph Stiglitz recently advised in a January *Project Syndicate* article, "Let bygones be bygones." China should not have built so many steel mills, but given that it has, it is likely better to use that steel to build subways in China and bridges in Pakistan than to shut the mills down.

Over the longer term, whether growth slows to 6 percent or 2 percent, further government reform is essential to sustainable growth. The party communique of November 2013 outlines many good ideas, including a more balanced set of incentives and tools for local officials instead of a singular focus on growth, a better social security system that would encourage a more typical level of consumption, and a richer set of environmental policies that would reduce the use of fossil fuel–burning vehicles and emissions from industry. Developing specific policies for these general themes is the key to healthy development in the age of the New Normal. ●

**FURTHER READING**

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